# INDEX


| | Page |
|---|---|
| Opinions below | 1 |
| Jurisdiction | 1 |
| Question presented | 2 |
| Statutes involved | 2 |
| Statement | 2 |
| Argument | 6 |
| Conclusion | 9 |
| Appendix | 10 |


## CITATIONS

Cases:


| | |
|---|---|
| *American Package Corp.* v. *Commissioner*, 125 F. 2d 413 | 8 |
| *Cedarburg Canning Co.* v. *Commissioner*, 149 F. 2d 526 | 8 |
| *Commissioner* v. *Affiliated Enterprises*, 123 F. 2d. 665, certiorari denied, 315 U. S. 812 | 8 |
| *O'Sullivan Rubber Co.* v. *Commissioner*, 120 F. 2d 845 | 8 |
| *Porto Rico Coal Co.* v. *Commissioner*, 126 F. 2d 212 | 8 |
| *Smith, Frederick, Enter. Co.* v. *Commissioner*, 167 F. 2d 356 | 8 |


Statutes:


| | |
|---|---|
| Internal Revenue Code: | |
| Sec. 23 (26 U.S.C. 1946 ed., Sec. 23) | 8, 10 |
| Sec. 500 (26 U.S.C. 1946 ed., Sec. 500) | 7, 11 |
| Sec. 505 (26 U.S.C. 1946 ed., Sec. 505) | 7, 8, 11 |
| Revenue Act of 1938, c. 289, 52 Stat. 447: | |
| Sec. 23 | 12 |
| Sec. 401 | 12 |
| Sec. 406 | 12 |
| Revenue Act of 1942, c. 619, 56 Stat. 798, Sec. 121 | 7, 8, 10, 12 |

# In the Supreme Court of the United States

OCTOBER TERM, 1948

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No. 471

WILSON BROS. & CO., PETITIONER

*v.*

COMMISSIONER OF INTERNAL REVENUE

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*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT*

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## BRIEF FOR THE RESPONDENT IN OPPOSITION

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### OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 30-47) are reported at 10 T.C. 251. The opinion of the Court of Appeals (R. 58-62) is reported at 170 F. 2d 423.

### JURISDICTION

The judgment of the Court of Appeals was entered November 2, 1948. (R. 63.) The petition for a writ of certiorari was filed on December 20, 1948. The jurisdiction of this Court rests upon 28 U.S.C., Sec. 1254.

### QUESTION PRESENTED

Whether, in the computation of income subject to personal holding company surtax for the years 1938 to 1942, inclusive, taxpayer is entitled to deductions for expenses and depreciation on two boats under Section 23 (a) and (l) of the Revenue Act of 1938 and of the Internal Revenue Code despite the provisions of Section 505 (b) of the Code and its counterpart in the Revenue Act of 1938.

### STATUTES INVOLVED

The pertinent statutes are set forth in the Appendix, *infra,* pp. 10-12.

### STATEMENT

The facts found by the Tax Court pertinent to the single issue raised on appeal (R. 33-38) are as follows:[1]

Wilson Bros. & Company, the taxpayer, is a Nevada corporation with its principal office at San Francisco, California. It filed its tax returns on the accrual basis. During the taxable years 1938 to 1942 the corporation was a personal holding company. (R. 33.)

The corporation was organized in December, 1928, by W. T. Wilson and his brother F. A. Wilson, each of whom paid $500 for one-half of its capital stock of $1,000 represented by 40 shares. Thereafter they jointly contributed to paid-in surplus $624,000 and two schooners, the "Oregon" and

[1] The case in the Tax Court involved additional issues as to which no appeal was taken from the Tax Court's decision.

the "Idaho". The "Oregon", in which the brothers owned a 100 per cent interest, and the "Idaho", in which they owned a 75 per cent interest, were transferred to the corporation at a value of $175,000. As an additional contribution to paid-in surplus the brothers on March 20, 1931, transferred to the corporation a bank account of $480,372.24 which they had received as a gift from their mother. At the time of this transfer it was orally agreed between them that either might at any time make withdrawals not exceeding $150,000 from the corporation and repay the amounts without interest when convenient to the drawer or necessary for the corporation's business. (R. 33-34.)

The brothers were successfully engaged as partners in the milling, shipping and selling of lumber on the west coast of the United States. They operated logging camps and sawmills, manufactured lumber in Washington, which they shipped on the two schooners, the "Oregon" and the "Idaho", for sale in San Francisco, Los Angeles and San Diego. The business was begun by their grandfather, continued by their father, and they participated in it from early youth. After 1928 it was conducted by the corporation. (R. 33-34.)

The two schooners transferred to the corporation are wooden-hulled vessels of 1,800 tons, dead weight, with cargo space for 1,200,000 board feet of lumber. After being operated by the corporation for a part of the year 1929, they were "laid up"

because a lull in the lumber market left the brothers with large unsold stocks on hand. For some years thereafter the brothers expected to put the ships back into service and to transport lumber in them again when market conditions should improve. But in succeeding years conditions grew worse and they have never been used. They have been kept moored, however, under the care of a watchman who cleans and paints the superstructure, and at intervals of 15 to 18 months they are placed in drydock for general overhauling, caulking and repairs. While not seaworthy since 1929, they have been maintained in such a condition that they could be made so within a period of 60 to 90 days. (R. 37.)

In 1938 W. T. Wilson took over individually a retail branch of the corporation's business, selling pine to motion picture studios and others from the office and lumber yard which the corporation formerly used. In that year the corporation ceased to deal in lumber and has since then derived no income from its sale. Its only business has been the care of investments and the collection of dividends and a small amount of rent. (R. 36, 37.)

With the cash contributions of the two brothers the corporation purchased stocks, principally of domestic corporations. In 1938 and succeeding years its security holdings exceeded $800,000 in value and it derived over 80 per cent of its income from dividends. F. A. Wilson, its president and

general manager, and W. T. Wilson, its secretary and treasurer, gave attention to its investments. During the taxable years 1938 to 1942, inclusive, they followed market reports, made some slight changes in holdings, exercised rights, and once purchased stocks with the proceeds of some matured bonds. F. A. Wilson had charge of maintaining and repairing the two schooners which were not in use; of finances and collections; and of the preparation of tax returns. In 1940 he exerted unusual efforts in preparing for the presentation of a tax case by the corporation. He was a member of the San Francisco Stock Exchange and operated a brokerage business. He also looked after his personal security portfolio, containing stocks of a value of about $200,000. W. T. Wilson kept the corporation's accounts and also engaged in the retail lumber business at Los Angeles which he took over from the corporation in 1938. (R. 35-36.)

During the years 1938-1942 numerous efforts were made by both brothers to sell or lease the two schooners, the "Oregon" and "Idaho". Some offers were received but not accepted. Being of wood, they are inferior to ships having steel hulls and cannot be as readily leased or sold. During the war they were not desired by the Maritime Commission because they were slow and small. The corporation received no rent or other compensation for the use of the schooners during the years 1938

to 1942, inclusive. The ships were not held in the course of the corporation's business in those years and were not necessary to the conduct of that business. (R. 37-38.)

For the years 1938-1942 the following amounts were claimed and allowed for income tax purposes as depreciation and expenses connected with the two ships (R. 38):

| Year | Total | Depreciation | Expenses |
|---|---|---|---|
| 1938 | $12,459.96 | $10,002.08 | $2,457.88 |
| 1939 | 15,094.35 | 10,002.08 | 5,092.27 |
| 1940 | 15,028.68 | 10,002.08 | 5,026.60 |
| 1941 | 16,166.87 | 10,002.08 | 6,164.79 |
| 1942 | 12,898.05 | 10,002.08 | 2,895.97 |

The Commissioner disallowed these amounts as deductions in determining deficiencies in personal holding company surtax. (R. 32, 38.)

The Tax Court held that the disallowance of the deductions for personal holding company surtax purposes was proper (R. 43-46) and, on appeal to the Court of Appeals on that one issue, the decision was affirmed (R. 58-62).

## ARGUMENT

This case does not raise the question whether depreciation and other expenses with respect to the two ships are deductible in computing the corporation's ordinary income taxes. The tax here involved is the special surtax on holding companies, and the statute spells out with particularity (see

Section 505(b), Appendix, *supra*, pp. 11-12) the limitations upon such deductions.

Section 500 of the Code imposes a surtax upon the "undistributed subchapter A net income of *every* personal holding company" (italics supplied) and Section 505 provides that "Subchapter A Net Income" means the net income with certain stated adjustments which include the provisions of subsection (b) denying deductions under Section 23 (a) and (l) except under stated conditions which taxpayer does not contend it has met. Section 505 (b) is entitled "Deductions Not Allowed" and is specific, unambiguous, and applicable to all personal holding companies.

There is no reason to conclude that, as taxpayer contends, Congress nevertheless intended the statute to be limited in its application to situations created for tax avoidance purposes. Concededly, the statute was originally designed in part at least to prevent tax avoidance by precluding individuals from obtaining deductions for expenses and depreciation on property they transferred to their personal holding company and on which they could not have obtained such deductions had they held the property individually. But, as the court below stated (R. 61), in correcting an evil Congress is not narrowly confined to the specific instances which suggested the remedy. By Section 121 of the Revenue Act of 1942, c. 619, 56 Stat. 798, Congress amended Section 23 (a) and (l) to add deductions

for expenses and depreciation on property held for the production of income (see Pet. 5-6) and it is on the basis of these amendments that taxpayer is claiming deductions. The amendments to Section 23 (a) and (l) were not, however, accompanied by an amendment to Section 505 (b) and that section continued to deny deductions under Section 23 (a) and (l) for personal holding company surtax purposes to the extent stated therein. The amendment to Section 23 (a) was specifically made applicable only to individuals. Thus, it would seem clear that Congress did not intend to allow the additional deductions under Section 23 (a) and (l) for personal holding company surtax purposes, either generally or in situations not created to avoid tax.[2] The absence of a tax avoidance motive therefore does not relieve taxpayer from the application of Section 505 (b). Cf. *Frederick Smith Enter. Co.* v. *Commissioner,* 167 F. 2d 356, 358-359 (C.A. 6); *Cedarburg Canning Co.* v. *Commissioner,* 149 F. 2d 526, 528 (C.A. 7); *Porto Rico Coal Co.* v. *Commissioner,* 126 F. 2d 212, 213 (C.A. 2); *American Package Corp.* v. *Commissioner,* 125 F. 2d 413, 416-417 (C.A. 4); *Commissioner* v. *Affiliated Enterprises,* 123 F. 2d 665, 667 (C.A. 10), certiorari denied, 315 U. S. 812; and *O'Sullivan Rubber Co.* v. *Commissioner,* 120 F. 2d 845, 847 (C.A. 2).

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[2] As the court below stated, individuals have other advantages which Section 505 (c) and (d) (26 U.S.C. 1946 ed., Sec. 505) denies for personal holding company surtax purposes. These relate to net loss carry-over and capital loss carry-over.

Contrary to taxpayer's assertion, the decision below is not in conflict with the various decisions relied upon in the petition (pp. 9-10). The issues raised by those cases are far removed from the issue herein and the cases, so far as pertinent here, merely apply the principle that the legislative intent should be given effect in the interpretation of a statute. The decision below does not reject or violate that principle.

## CONCLUSION

The decision below is correct and involves no conflict of decisions. The petition for a writ of certiorari should therefore be denied.

Respectfully submitted,

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JANUARY, 1949.

APPENDIX

Internal Revenue Code:

SEC. 23 [as amended by Sec. 121 of the Revenue Act of 1942, c. 619, 56 Stat. 798]. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) *Expenses.*—

(1) *Trade or business expenses.*—

(A) *In general.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, * * *.

* * * * *

(2) *Non-trade or non-business expenses.*—In the case of an individual, all the ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income, or for the management, conservation, or maintenance of property held for the production of income.

* * * * *

(l) *Depreciation.*—A reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

(1) of property used in the trade or business, or

(2) of property held for the production of income.

* * * * *

(26 U.S.C. 1946 ed., Sec. 23.)

SUBCHAPTER A—PERSONAL HOLDING COMPANIES

SEC. 500. SURTAX ON PERSONAL HOLDING COMPANIES.

There shall be levied, collected, and paid, for each taxable year beginning after December 31, 1938, upon the undistributed subchapter A net income of every personal holding company (in addition to the taxes imposed by chapter 1) a surtax equal to the sum of the following: [Here follow scheduled rates.]

(26 U.S.C. 1946 ed., Sec. 500.)

SEC. 505. SUBCHAPTER A NET INCOME.

For the purposes of this subchapter the term "Subchapter A Net Income" means the net income with the following adjustments:

* * * * *

(b) *Deductions Not Allowed.*—The aggregate of the deductions allowed under section 23 (a), relating to expenses, and section 23 (l), relating to depreciation, which are allocable to the operation and maintenance of property owned or operated by the corporation, shall be allowed only in an amount equal to the rent or other compensation received for the use of, or the right to use, the property, unless it is established (under regulations prescribed by the Commissioner with the approval of the Secretary) to the satisfaction of the Commissioner:

(1) That the rent or other compensation received was the highest obtainable, or, if none was received, that none was obtainable;

(2) That the property was held in the course of a business carried on bona fide for profit; and

(3) Either that there was reasonable expectation that the operation of the property would result in a profit, or that the property was necessary to the conduct of the business.

* * * * *

(26 U.S.C. 1946 ed., Sec. 505.)

The above provisions of Section 23 of the Internal Revenue Code are also contained in Section 23 of the Revenue Act of 1938, c. 289, 52 Stat. 447, as amended retroactively by Section 121 of the Revenue Act of 1942, c. 619, 56 Stat. 798. Substantially the same provisions as Sections 500 and 505 (b) of the Code are contained in Sections 401 and 406 of the Revenue Act of 1938.

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